

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:TEGE:EOEG:ET2:PRENO-164189-02
DRFord

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MANAGER, EXEMPT ORGANIZATIONS TECHNICAL GROUP 1

from: Lynne Camillo
Chief, Employment Tax Branch 2
CC:TEGE:EOEG:ET2

subject: **Employee Emergency Relief Funds and IRC 102(c) PRENO-164189-02**

This responds to the above-referenced technical assistance request. Specifically, you have requested our views on the federal tax consequences of section 102(c) of the Internal Revenue Code (the "Code") on certain employee relief funds established by section 501(c)(3) organizations.

FACTS

As we understand the facts of this matter, employees of a hospital ("Employer") established an "employee relief fund" ("Fund") pursuant to the Articles of Formation and Governance ("Articles"). The Fund has not been recognized as exempt under section 501(c)(3), however it was established exclusively for charitable purposes, to assist all health system employees, retirees and volunteers ("Eligible Persons") in times of emergency and financial need. The Articles provide that no part of the principal of the Fund shall be used for funding Employer's obligations to pay salaries, however it is considered an asset of the Employer. The Fund is supported by contributions from employees, retirees, volunteers and the general population. The Employer and its affiliates are prohibited from making contributions to the Fund by the Articles. We assume that contributors to the Fund are entitled to a deduction for a charitable contribution within the meaning of section 170 of the Code.

When an Eligible Person is in an emergency situation and is experiencing financial need, they can apply for help. A fifteen-member committee governs the Fund. The committee members are appointed by the Employer and are employees of the Employer or its affiliates. The identification of the applicants is withheld from the committee. If the committee decides to make a payment to the applicant, the

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committee instructs the Employer to transfer the payment from the Fund. The Employer has no discretion in the performance of the committee's function.

LAW

Section 61 of the Code provides that gross income means all income from whatever source derived, including compensation for services, fees, commissions, fringe benefits and similar items.

Section 1.61-21(a)(1) of the Treasury regulations provides that, except as otherwise provided, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items.

Section 1.61-21(a)(2) of the regulations provides that, to the extent that a particular fringe benefit is specifically excluded from gross income pursuant to another section of the Code, that section shall govern the treatment of that fringe benefit.

Section 1.61-21(a)(3) of the regulations states a fringe benefit provided in connection with the performance of services shall be considered to have been provided as compensation for such services.

Section 1.61-21(a)(5) of the regulations states a provider of a fringe benefit is that person for whom the services are performed, regardless of whether that person actually provides the fringe benefit to the recipient. The provider of a fringe benefit need not be the employer of the recipient of the fringe benefit, but may be, for example, a client or customer of the employer or of an independent contractor.

Section 102(a) of the Code provides gross income does not include the value of property acquired by gift, bequest, devise, or inheritance.

Section 102(c)(1)(a) of the Code states any amount transferred by or for an employer to, or for the benefit of, an employee is not excludable from gross income as a gift.

Section 1.102(f)(2) of the Proposed Regulations provides only one exception to section 102(c). Extraordinary transfers to the natural objects of an employer's bounty are not considered transfers to, or for the benefit of, an employee if the employee can show that the transfer was not made in recognition of the employee's employment.

Section 3121(a) defines the term "wages" for Federal Insurance Contributions Act (FICA) purposes as all remuneration for employment, with certain specific exceptions not relevant here. The Code provisions relating to income tax withholding and the Federal Unemployment Tax Act (FUTA) contain similar definitions. See IRC §§ 3401(a); 3306(b).

Section 31.3121(a)-1(i) of the Treasury Regulations provides that remuneration for

employment, unless such remuneration is specifically excepted, constitutes wages even though at the time paid the relationship of employer and employee no longer exists between the person in whose employ the services were performed and the individual who performed them.

ANALYSIS

We are not aware of any IRS guidance, informal or otherwise, specifically addressing the issues presented. However, in our view, the facts you describe are somewhat similar to the facts set forth in a private letter ruling recently issued by the Income Tax and Accounting Division concerning contributions by employees to a charitable fund set up to benefit employees experiencing financial hardship, PLR 200307084.

PLR 200307084 involved a situation where employees could contribute to a fund set up by an employer to make grants or loans to employees experiencing temporary extreme financial hardship. The fund was organized as a public charity exempt from federal income tax under Code section 501(c)(3), and was principally funded by donations from managerial employees of the employer. Selection of aid recipients was made by an independent selection committee based on objective criteria and determination of need. The Service ruled that payments made to employee recipients were gifts under section 102(a) and therefore, were not includible in the recipients' gross income and were not subject to employment taxes. The Service also ruled that employees who made donations to the fund were entitled to a deduction for a charitable contribution within the meaning of section 170 of the Code. The Service offered the following rationale to support its ruling:

In the present case, although the payments at issue are made to employees, such payments are not made directly by or for the employer. Instead, the payments are made by the Fund, which qualifies as a tax exempt public charity under section 501(c)(3). Under certain conditions, payments provided to employees through a public charity will be deemed not to have been made "by or for the employer," thus rendering section 102(c) inoperative and allowing section 102(a) to serve as a means to exclude an otherwise includible fringe benefit in gross income.

Generally, an organization exempt under section 501(c)(3) is established and operates in such a way that payments to members of a charitable class from the organization are not made by or for an employer. Where, as here, payments are made to eligible recipients through a publicly funded charity that is not controlled by the employer, selection of the recipients is based on an objective determination of need, and the recipients are selected by an independent committee or adequate substitute procedures, it is our view that the charitable purpose is primarily being accomplished, and the employer is receiving a benefit that is not more than insubstantial.

While the facts in the instant case are similar to those in PLR 200307084, the major distinction is that the fund in that ruling is a public charity exempt from federal income tax under Code section 501(c)(3). By contrast, the facts you describe involve a Fund that has not been recognized as exempt under section 501(c)(3) and therefore has no separate and independent existence apart from the Employer. For this reason, it is our view that the rationale set forth in the PLR does not apply to the facts you describe. Because the Fund you describe is not an exempt organization under section 501(c)(3), there would be less than adequate assurance that the Fund is established and operates in such a way that payments to Eligible Persons from the Fund are not made by or for the Employer. Under these facts, where the Employer maintains and administers the Fund as its own asset, we see no basis for concluding that transfers from the Fund to Eligible Persons are not made by or for the employer within the meaning of section 102(c). Thus, there is not an adequate basis for concluding that the amounts received by Eligible Persons from the Fund are not includable in income and not subject to employment tax.

Employees and Retirees

Employees, retirees, volunteers and the community contribute to the Fund. The Committee decides how the funds will be disbursed and the Employer provides administrative functions such as accounting services including transferring payments from the Fund to recipients. Even though the source of the funds does not originate from the Employer, and the Employer only acts as a trustee with no discretion regarding how the funds are distributed, a payment from the Fund should be included in the recipient's gross income under section 61 of the Code. Employees and retirees are eligible to receive benefits from the fund because of their employment relationship (or former employment relationship) with the Employer. Therefore, benefits from the fund are provided in connection with the performance of services and are presumed to be compensation under regulations section 1.61-21(a)(3). "A provider of a fringe benefit is that person for whom the services are performed, regardless of whether that person actually provides the fringe benefit to the recipient. The provider need not be the employer of the recipient." §1.61-21(a)(5) of the Treasury Regulations. Additionally, under section 102(c)(1), "any amount transferred by...an employer to... an employee is not excludible from gross income."¹ Therefore, any payment transferred to either employees or retirees is included in income.

Employees are eligible to receive a payment from the Fund because of their employee-employer relationship with the Employer. With exceptions not material here, the term "wages" is defined in the FICA as all remuneration for employment. The Code provisions relating to income tax withholding and FUTA contain similar definitions. The term "employment" is further defined as any service performed by an employee for the person employing him. The facts indicate that any payment from the Fund transferred by the Employer to employees or retirees is remuneration for services or past services.

¹ The one exception to §102(c)(1) is any gift from an employer to an employee, who is "the nature of one's bounty," is not relevant here.

Accordingly, based on the information provided, we conclude that the amounts transferred by the Employer to the employees and retirees are wages for purposes of the employment taxes.

Volunteers

Any payment from the Fund to a volunteer who performs services would be considered to be a form of compensation for services and therefore included in the volunteer's gross income. To be eligible to receive a payment from the Fund, a volunteer must be currently performing services or must have performed services in the past. Volunteers only become eligible to receive payments from the Fund in return for volunteering to perform services for the Employer. Therefore, payments from the Fund to volunteers represent compensation for services and must be included in gross income.

Whether or not payments from the Fund to volunteers are subject to employment taxes depends on whether the volunteer has the status of an employee, and whether the payments are "wages" as that term is defined in the FICA, FUTA, and in section 3401(a) of the Code for purposes of federal income tax withholding. The volunteers will be considered employees for employment tax purposes if they have the status of employees under the usual common law rules applicable in determining the employer-employee relationship. Guides for determining that status may be found in section 31.3121(d)-1(c), 31.3306(i)-1, and 31.3401(c)-1 of the Treasury regulations.

If you have any questions or wish to discuss this matter further, please contact David Ford at 622-3329.